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# CRS Issue Brief

## Most-Favored-Nation Status of the People's Republic of China

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## Most-Favored-Nation Status of the People's Republic of China

### SUMMARY

The Tiananmen Square massacre of June 4, 1989, and the repressive policies and violations of human rights by the Chinese Government that followed it, have led to the imposition by the United States of some economic and other sanctions against China and to consideration of additional sanctions, among them the withdrawal of China's most-favored-nation (MFN), or nondiscriminatory, status in trade with the United States. After having been suspended in 1951, MFN status was restored to China in 1980 conditionally under the Jackson-Vanik freedom-of-emigration amendment of the Trade Act of 1974 and must be renewed annually. The lapse or withdrawal of the MFN status would result principally in the imposition of substantially higher U.S. customs duties on some 95% of U.S. imports from China (totaling \$31,425.4 million in 1993) and a likely cut-back in such imports as well as possible retaliatory reduction by China of its imports from the United States. There is also

likely to result a significant economic disadvantage for Hong Kong.

Various legislation introduced in the 102nd Congress to withdraw or severely restrict China's MFN status failed to be enacted, in two instances for failure of overriding the President's veto. The 103rd Congress, thus far, failed to pass legislation to disapprove the mid-1993 extension of China's MFN status, while active consideration of measures to subject the renewal of China's MFN status in mid-1994 to additional human rights and international security conditions ceased because of similar measures implemented by the President. Since the President's recommendation in early June 1994 to extend China's MFN status without additional conditions, however, congressional activity to restrict or suspend China's MFN status has been renewed. China MFN legislation also reflects a new congressional concern: harmful effects on U.S. trade of China's manipulation of its currency's exchange rate.

## **MOST RECENT DEVELOPMENTS**

*While extending, on May 28, 1993, China's MFN status, the President also issued an Executive Order containing provisions similar to those of some legislative measures, outlining the areas in the field of human rights in which China will have to make significant progress if the waiver is to be renewed in mid-1994. H.J.Res. 208, introduced to disapprove the extension, failed of passage in the House on July 21, 1993, and because of the President's action, consideration of bills introduced in both Houses to place additional conditions on the mid-1994 renewal China's MFN status ceased.*

*On June 2, 1994, President Clinton sent to Congress his determination to renew China's MFN status for another year, together with an explanation of his action. Measures have been introduced to disapprove the 1994 renewal, and to subject annual renewals to human rights and other conditions.*

## **BACKGROUND AND ANALYSIS**

### **China's MFN Status**

The United States has applied most-favored-nation (MFN) treatment in trade as a matter of statutory policy, enacted in 1934, generally to all of its trading partners. This policy was modified with the enactment of section 5 of the Trade Agreements Extension Act of 1951 (P.L. 82-50), which required the President to suspend MFN status of the Soviet Union and all countries of the then Sino-Soviet bloc. Under this statutory mandate, President Truman suspended China's most-favored-nation status as of Sept. 1, 1951. After China's occupation of Tibet, that country's MFN status was suspended as of July 14, 1952. MFN status could thereafter be restored to any of the suspended countries only by specific law, until the Trade Act of 1974, in Title IV, provided special authority and set out the conditions and the procedure for its restoration to "nonmarket economy" (NME) countries and subsequent continuation in force.

The key elements of the procedure for restoring MFN status are (1) the conclusion of a bilateral trade agreement containing a reciprocal grant of the MFN status and additional provisions required by law, and approved by the enactment of a joint resolution; and (2) compliance with the freedom-of-emigration requirements ("Jackson-Vanik amendment") of the Trade Act of 1974. The latter requirements can be fulfilled either by a Presidential determination that the NME country in question places no obstacles to free emigration of its citizens, or by a Presidential waiver of full compliance, under specified conditions.

The continuation in force of the MFN status is contingent on (1) triennial renewal of the trade agreement by a Presidential determination that a satisfactory balance of trade and services has been maintained during its life and that the U.S. reductions in trade barriers resulting from multilateral negotiations (which also benefit China because of its MFN status) have been satisfactorily reciprocated; and (2) annual renewal of the waiver authority and existing waivers, which is automatic upon Presidential recommendation, in mid-year, unless vitiated by the enactment of a joint resolution of disapproval.

In accordance with this procedure, the President, on Oct. 23, 1979, transmitted to Congress the trade agreement with China, signed on July 7, 1979, its proclamation, and the executive order extending to China the Jackson-Vanik waiver (H.Doc. 96-209). The agreement was approved by Congress on Jan. 24, 1980 (H.Con.Res. 204, 96th Congress) and entered into force (together with the reciprocal grant of the MFN status which it contains in addition to all other provisions required by section 405(b) of the Trade Act of 1974) on Feb. 1, 1980.

The agreement has been thus far renewed four times, most recently as of Feb. 1, 1992, through Jan. 31, 1995 (Presidential Determination No. 92-12 of Jan. 31, 1992, 57 F.R. 19077). The Jackson-Vanik overall waiver authority and China's waiver, similarly, have been extended annually, although often not without Congressional attempts at disapproving the extension of China's waiver.

### **Withdrawing or Restricting China's MFN Status**

MFN status can be withdrawn from China in several ways: (1) by appropriate direct legislation enacted through regular legislative process; (2) by using the specific means provided in the Trade Act of 1974 for denying MFN status to a NME country that had it restored under that law, i.e., by the fast-track enactment of a joint resolution disapproving the mid-year annual renewal of the Jackson-Vanik waiver authority with respect to China, if such renewal is recommended by the President, or (3) by the President's failure to recommend such renewal with respect to China in the first place (e.g., for noncompliance with the Jackson-Vanik requirements). (In 1994, recommendation for renewal could have been withheld also for noncompliance with the conditions set by Executive Order 12850; see below). China also can lose its MFN status if the automatic 3-year extension of the U.S.-China trade agreement does not take place because the requirements for it have not been met.

Restrictions of varying severity or scope can be applied to China's MFN status by specific legislation enacted under the regular procedure.

In the years past, the Congress has often attempted to terminate or restrict China's MFN status by means of joint resolutions disapproving the annual extension of China's waiver or by specific legislation, or subject its continuation in force to additional conditions, primarily in the area of human rights. None of these measures became law, although two of them (one in either session of the 102nd Congress) to set additional conditions for the annual extensions of MFN status) came close to being enacted: passed by both Houses, they were vetoed by the President and the veto was upheld by the Senate.

In the 1st session of the 103rd Congress, several bills titled "United States-China Act of 1993" were introduced early on, reflecting the vetoed measure of the previous session in their operative provisions but differing slightly from one another in their preliminary findings and/or policy statements. H.R. 1835, 1890, and 1991, and S. 806 would prohibit the President from recommending, in mid-1994, a continuation of China's waiver and, hence, MFN status, unless he reports to Congress that China has taken specific actions and made significant progress in a variety of human rights and international security areas. A different concern is addressed in S. 1034, which prohibits the President from recommending an extension of China's waiver in 1994

unless he determines that China has ceased manipulating the dollar/yuan exchange rate. An outright termination of China's MFN status and a prohibition to restore it under Title IV of the Trade Act is contained in S. 1065.

In order to maintain in force the Jackson-Vanik waiver for China, the President, on May 28, 1993, extended China's waiver -- and, thus, MFN status -- for another year. At the same time, however, in Executive Order 12850, the President also set specific additional conditions for the mid-1994 extension of China's waiver and MFN status, closely reflecting the requirements of the several versions of the United States-China Act of 1993. In addition to requiring compliance with the Jackson-Vanik amendment, E.O. 12850 sets the following conditions: compliance with the 1992 U.S.-China prison labor agreement, and significant progress with respect to China's adherence to the Universal Declaration of Human Rights, releasing and accounting for Chinese citizens imprisoned or detained for the nonviolent expression of political and religious beliefs, ensuring humane treatment of prisoners by allowing access to prisons by international humanitarian and human rights organizations, protecting Tibet's religious and cultural heritage, and permitting international radio and TV broadcasts into China. The E.O. also charges U.S. officials to pursue resolutely actions to ensure that China keeps its commitments to follow fair, nondiscriminatory trade practices in dealing with U.S. businesses, and adheres to the Nuclear Non-Proliferation Treaty, the Missile Technology Control Regime guidelines, and other nonproliferation commitments.

While China denounced the action taken by the President, the principal sponsors in both Houses of the legislation to subject the 1994 extension of China's MFN status to additional conditions (Representative Pelosi and Senator Mitchell) expressed their satisfaction with the President's action as representing a sufficient step, and stated that congressional action on their respective bills would be unnecessary.

A measure to disapprove altogether the 1993 extension of the waiver authority for China was H.J.Res. 208. After a hearing on the subject by the House Ways and Means Subcommittee on Trade and an adverse report on July 1, 1993 (H.Rept. 103-167), H.J.Res. 208 was defeated in the House (105-318) on July 21, 1993, permitting the continuance in force of China's MFN status.

After much speculation -- due to the perception that China's compliance with the conditions set by E.O. 12850 had not improved greatly -- as to whether the President would extend China's waiver, and strong advocacy in Congress and in the public at large of opposing positions with respect to the waiver renewal, President Clinton, on May 26, 1994, announced that the waiver would be renewed. While the grounds for the renewal and the extent to which they satisfy the conditions of E.O. 12850 were explained in the President's official communication of June 2, 1994, to the Congress (H. Doc. 103-266), the document also notes significant shortcomings in virtually all areas covered by the E.O.

On June 8, 1994, H.J.Res. 373, to disapprove the extension of the waiver authority with respect to China, was introduced and referred to Ways and Means Committee. H.R. 4590, introduced on June 16, 1994, and referred to Ways and Means, and Rules Committees, provides for disapproval by joint resolution -- for failure to meet the conditions of E.O. 12850 -- of the applicability of annual extensions of MFN status to imports of products made or exported by Chinese state-owned enterprises; if the 1994 waiver renewal is not disapproved, it will not apply to imports of goods made or

exported by the Chinese Army or a defense industrial trading company, or of most major product categories made or exported by Chinese state-owned enterprises. (For greater detail on these measures, see **Legislation**, below.)

Denial of China's MFN status, in whichever manner brought about, would have to be implemented also with having regard of two relevant provisions of the U.S.-China trade agreement, addressing specifically the discontinuance of the agreement or of any of its provisions. In its automatic 3-year extension provision (Article X.2), the agreement allows for its termination if either party to it "notifies the other of its intent to terminate this Agreement at least thirty (30) days before the end of a term." The agreement also provides (in Article X.3) that "if either Contracting Party does not have domestic legal authority to carry out its obligations under this Agreement, either Contracting Party may suspend application of this Agreement, or, with the agreement of the other Contracting Party, any part of this Agreement." This provision appears to be applicable with respect to MFN treatment in the event that the waiver authority is withdrawn under the Jackson-Vanik amendment.

In addition, a more generally applicable provision (Article IX), which asserts "the right of either Contracting Party to take any action for the protection of its security interests," might conceivably, if circumstances would warrant, be used to suspend the MFN treatment.

### Effects of Withdrawing China's MFN Status

Based on 1993 data, the termination of China's MFN status would result in duty increases on about 95% of U.S. imports from China. The cost effect of the increases would vary among the various product groups, but would on the whole be substantial.

The following table illustrates how the withdrawal of the MFN status would affect the effective duty rates assessed on some major U.S. import items from China.

**Table 1. Illustrative MFN and Full Duty Rates  
Applicable to Some Major Imports from China**

	<u>MFN Rate</u>	<u>Full Rate</u>
Frozen shrimp	Free	Free
Men's trousers, man-made fiber	29.7%	90%
Knit women's sweaters	6%	60%
Silk blouses or shirts	7.5%	65%
Plastic or rubber footwear	6%	35%
Women's leather footwear	10%	20%
Artificial flowers	9%	71.5%
Crude petroleum	10 5c/bbl (= 0.62%)	21c/bbl (= 1.24%)
Radio/tape players	3.7%	35%
Electric hair driers	3.9%	35%
Luggage and handbags, textile fiber	20%	65%
Plastic handbags and travel bags	20%	45%
Toys	Free	70%



In view of the overall substantial differences between the concessional (MFN) and full rates of duty, it is clear that the termination of China's MFN status would result in substantial increases in the cost of imports from China. Based on our survey of the 45 individual items whose imports in 1992 exceeded \$100 million each and whose total accounted for \$11.4 billion (45%) of all U.S. imports from China in that year, the termination of China's MFN status would increase the average importers' cost of Chinese products by some 36%, in most individual instances between 25% and 65%, but also on occasion substantially more. Relative cost increases would be high particularly on low-margin consumer goods (clothing, household electrical and electronic products, toys, etc.), of which China is a substantial supplier, possibly to the point where many of the products would be priced out of the U.S. market. Much of the sourcing of products now imported from China would be likely to shift to other countries or domestic producers with higher prices but subject to MFN or no duties. This would still result in increased costs, which would affect disproportionately low-income U.S. consumers.

On the Chinese side, such changes would obviously reduce significantly the U.S. demand for such imports from China. The size of this reduction and its adverse effect on China's economy would depend on a number of factors, but, in the opinion of several China trade experts, would be substantial. It would be, it is claimed, particularly damaging to the economy of China's southern provinces (Fujian and Guangdong) that are most dependent on exports and where much of China's exports originate. Indirectly, it would also adversely affect Hong Kong and the economic benefits it derives from being the port of transit for about 70% of China's exports to the United States, and whose businessmen also have substantial manufacturing interests in the neighboring southern China.

Depending on whether and, if so, in what way and to what extent China would retaliate against imports from the United States (by increasing its tariffs to non-MFN levels, or taking other import-restrictive measures), the annual loss of U.S. exports to China could be significant, most likely affecting U.S. exports of grain, power generating machinery, aircraft, and fertilizer products.

## **LEGISLATION**

### **H.J.Res. 208 (Solomon)**

Disapproves the extension of the Jackson-Vanik amendment waiver authority to China. Introduced June 8, 1993; referred to Ways and Means Committee; hearing on U.S.-China trade relations held by Ways and Means Trade Subcommittee June 8, 1993; measure adversely reported (H.Rept. 103-167) July 1, 1993; defeated (105-318) in the House July 21, 1993.

### **H.J.Res. 373 (Solomon)**

Disapproves the extension of the Jackson-Vanik amendment waiver authority to China. Introduced June 8, 1994; referred to Ways and Means Committee.

**H.R. 1835 (Pelosi); H.R. 1890 (Pelosi); H.R. 1991 (Smith, C.); and S. 806 (Mitchell)**

**United States-China Act of 1993.** (Four identically titled but slightly different bills, containing various congressional findings and policy statements, and subjecting the mid-1994 extension of China's MFN status to additional conditions; conditions would apply only to MFN status of imports from Chinese state-owned enterprises. Consideration of these measures -- which reached various stages as shown below -- was set aside after President Clinton issued (May 28, 1993) E.O. 12850, making the 1994 extension of China's waiver subject to China's significant progress in the field of human rights (H. Doc. 103-97), a requirement practically identical to provisions of the United States-China Trade Act.

*H.R. 1835:* Introduced Apr. 22, 1993; referred jointly to Committees on Ways and Means, Rules, and Foreign Affairs; hearing on U.S.-China trade relations held by Ways and Means Trade Subcommittee June 8, 1993.

*H.R. 1890:* Introduced Apr. 28, 1993; referred jointly to Committees on Ways and Means, and Rules.

*H.R. 1991:* Introduced May 5, 1993; referred jointly to Committees on Ways and Means, Foreign Affairs, and Rules; joint hearing on the future of U.S.-China policy held May 20, 1993, by Foreign Affairs Subcommittees on Economic Policy, Trade and Environment; Internal Security, International Organizations and Human Rights; and Asia and the Pacific.

*S. 806:* Introduced Apr. 22, 1993; referred to Committee on Finance.

**H.R. 4590 (Pelosi)**

**United States-China Act of 1994.** Contains specific findings that the conditions set by E.O. 12850 for the 1994 renewal of China's MFN status have not been met; provides for fast-track enactment of a joint resolution disapproving, for failure to meet the standards described in E.O. 12850, the annual renewal of the waiver authority for China, the disapproval applying only to goods produced, manufactured, or exported by a state-owned enterprise; if the 1994 MFN status renewal takes effect, its application is prohibited to goods produced, manufactured, or exported by the Chinese Army or defense industrial trading companies or to specified categories of goods produced, manufactured, or exported by state-owned enterprises; requires the Secretary of the Treasury, as a condition of and subsequent to the granting of MFN status, to consult with American businesses trading with or investing in China to encourage them to adopt a voluntary human rights code of conduct; requires the determination, within 90 days, and publication of a list of Chinese state-owned enterprises and defense industrial trading companies; provides a procedure and detailed definitions of operational terms for making such determinations; requires semiannual reports by the Secretary of the Treasury to the Congress on the determination activity and code-of-conduct consultations; authorizes the President to waive any condition or prohibition if he determines and reports to the Congress that its continued imposition would have a serious adverse effect on the vital national security interests of the United States; requires the President, if he recommends the renewal of the waiver in 1995, to report to the Congress to what extent China has made progress with respect to four key issues (adherence to the provisions of the Universal Declaration of Human Rights, cessation of convict-made exports to the United States, cessation of unfair and discriminatory

trade practices burdening U.S. trade, and adherence to the guidelines of international missile-technology and nuclear controls); if the President does not recommend the renewal of China waiver in 1995, he is required to undertake efforts to ensure that GATT members take a similar action with respect to China. Introduced June 16, 1994; referred to Ways and Means, and Rules Committees.

## **CONGRESSIONAL HEARINGS, REPORTS, AND DOCUMENTS**

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U.S. President, 1993- (Clinton). Continuation of waiver authority; communication from the President of the United States... Washington, U.S. Govt. Print. Off., 1993. 10 p. (103d Congress, 1st session. House Document 103-97).

Communication dated May 28, 1993. (Contains Presidential Determination 93-23, Executive Order 12850, and a report to Congress.)

----- Continuation of waiver authority; communication from the President of the United States... Washington, U.S. Govt. Print. Off., 1994. 13 p. (103d Congress, 2d session. House Document 103-266).

Communication dated June 2, 1994. (Contains Presidential Determination 93-26, and a report to Congress.)

## **CHRONOLOGY**

**06/16/94** --- H.R. 4590 introduced, mainly providing for disapproval--for failure to meet human rights conditions of E.O. 12850--of annual renewal of MFN status for products of Chinese state-owned enterprises and excluding from 1994 renewal, if granted, products made or exported by Chinese Army or defense industrial trading companies, or specified categories of goods made or exported by state-owned enterprises.

**06/08/94** --- H.J.Res. 373 introduced, disapproving the extension of MFN treatment to China.

- 06/02/94** --- The President recommended a one-year extension of China's MFN status (H. Doc. 103-266).
- 05/04/94** --- Subcommittee on East Asian and Pacific Affairs of the Senate Foreign Relations Committee held a hearing on U.S. policy toward China.
- 07/21/93** --- H.J.Res. 208, disapproving the extension of MFN treatment to China, defeated in the House (105-318). Extension of MFN status remains in effect.
- 07/01/93** --- H.J.Res. 208 adversely reported by Ways and Means Committee (H. Rept. 103-167).
- 06/08/93** --- H.J.Res. 208 introduced, disapproving the extension of MFN treatment to China.
- House Ways and Means Subcommittee on Trade held a hearing on U.S.-China trade relations.
- 05/28/93** --- The President recommended a one-year extension of China's MFN status but, in E.O. 12850, made the 1994 extension subject to China's significant progress in the field of human rights (H. Doc. 103-97). Principal sponsors of measures containing requirements similar to those of E.O. 12850 (Senator Mitchell, Representative Pelosi), subsequently, stated that further congressional action on their respective bills would be unnecessary.
- S. 1065 introduced, requiring the President to terminate China's MFN status.
- 05/26/93** --- S. 1034 introduced, prohibiting the President from renewing China's MFN status in mid-1994 unless he determines that China is not manipulating its currency to gain an unfair competitive advantage.
- 05/20/93** --- House Foreign Affairs Subcommittees on Economic Policy, Trade and Environment; Internal Security, International Organizations and Human Rights; and Asia and the Pacific held a joint hearing on the future of U.S.-China policy.
- 05/05/93** --- H.R. 1991 introduced, prohibiting the President from extending, in mid-1994, MFN treatment of products of China's state-owned enterprises unless specified human-rights and international-security conditions are met.
- 04/28/93** --- H.R. 1890 introduced, prohibiting the President from extending, in mid-1994, MFN treatment of products of China's state-owned enterprises unless specified human-rights and international-security conditions are met.
- 04/22/93** --- H.R. 1835 and S. 806 introduced, prohibiting the President from extending, in mid-1994, MFN treatment of products of China's state-owned enterprises unless specified human-rights and international-security conditions are met.

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